



County of Los Angeles
CHIEF ADMINISTRATIVE OFFICE

713 KENNETH HAHN HALL OF ADMINISTRATION • LOS ANGELES, CALIFORNIA 90012
(213) 974-1101
<http://cao.co.la.ca.us>

DAVID E. JANSSEN
Chief Administrative Officer

Board of Supervisors
GLORIA MOLINA
First District

YVONNE BRATHWAITE BURKE
Second District

ZEV YAROSLAVSKY
Third District

DON KNABE
Fourth District

MICHAEL D. ANTONOVICH
Fifth District

January 30, 2004

To: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Yvonne Braithwaite Burke
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

COMMERCIAL WORKERS' COMPENSATION INSURANCE: SYN #62, SYN #72

On June 6, 2000, your Board instructed the Director of Personnel, the Treasurer and Tax Collector, and the Auditor-Controller, to investigate the feasibility of debt and non-debt financing of the County of Los Angeles self-insured program for workers' compensation.

On November 14, 2000, your Board instructed the Chief Administrative Office (CAO), in conjunction with the Treasurer and Tax Collector and the Auditor-Controller, to submit a report on the status of the analysis of the workers' compensation insurance program and all associated projects. The analysis was to determine whether the County of Los Angeles (County) should remain self-insured on a "pay-as-you-go" basis or purchase commercial workers' compensation insurance.

This memorandum is in response to both of the above Board's requests, and it has been cleared with the Treasurer and Tax collector, and the Auditor-Controller.

Three primary factors were applied during CAO staff's evaluation of whether or not the County should purchase commercial workers' compensation insurance and execute a workers' compensation loss portfolio transfer. The first factor is the cost and availability of commercial workers' compensation insurance. Secondly, the current solvency and stability of the California insurance industry was reviewed. Finally, the timing of either the purchase of insurance or loss portfolio transfer was considered.

Background

Until 1995, California workers' compensation rates were regulated by the State of California's Insurance Commissioner. An insurer could not issue or renew a workers' compensation insurance policy, at premium rates less than those approved by the Insurance Commissioner. In 1995, California's minimum rate law was replaced with an open-competition system, in which insurers set their own rates. Price competition led to premium rate reductions, as insurers sought to retain or add to their market share. By 1997, industry-wide workers' compensation losses exceeded insurance premiums, and the financial condition of many insurers quickly began to erode.

The impact of rate deregulation and increased claim cost was evidenced in insurance industry combined ratios, the measure comparing claim and loss expenses to earned premiums, which exceeded 120% for each calendar year, from 1995 through 2002. Since 2000, the California workers' compensation insurance market has experienced:

- The average California Workers' Compensation premium rates, per \$100 of payroll, have increased 107% over the past two years.
- Over twenty insurance companies have gone under liquidation and are no longer in business.
- A number of workers' compensation insurers abandoned the California insurance market or limited underwriting practices. The State Compensation Insurance Fund, a public non-profit insurer, has seen its market share increase 80% in the two-year period from 2000 to 2002.
- The California Insurance Guarantee Association (CIGA), established to meet the obligations of insolvent workers' compensation insurers, recently reported its "precarious financial condition." CIGA states its cash, available to pay workers' compensation claims, is "nearly exhausted." AB 227, passed in 2003, attempted to remedy the crisis by enabling CIGA to finance through the California Infrastructure and Economic Development Bank.
- In February 2002, Assembly Bill 749 passed into law. The bill's roll out significantly increased the County's workers' compensation expense by approximately \$65.0M each year.

During 2003, the legislature enacted reforms to the State of California's workers' compensation system, that will eventually save the County \$25.0M each year. However, these reforms will take over three years to completely phase in.

Additional and significant reforms to the California workers' compensation system are critically needed. While County staff is playing a leading role in the 2004 reform effort, staff anticipates the need for reform beyond what was enacted in 2003 and what is likely to be enacted in 2004.

Recommendation

CAO staff researched the possibility of the County purchasing commercial workers' compensation insurance and executing a workers' compensation loss portfolio transfer. Discussions were held with representatives from AON Risk Services, the world's second largest risk and insurance broker, and American International Group (AIG), the world's largest insurance company. Both AON and AIG representatives informed staff that given the current financial condition of the insurance industry, and, specifically, the current "crisis" in the State of California workers' compensation system, that the County could not purchase commercial workers' compensation insurance or execute a workers' compensation loss portfolio transfer in the near future. The AON and AIG representatives recommended waiting, to again analyze both issues, no earlier than 2006.

Therefore, the CAO recommends maintaining the County's current self-funded and self-insured workers' compensation program.

Because we believe that the California workers' compensation system will remain unsettled for a minimum of two years, CAO staff will continue to monitor the insurance market place and investigate loss portfolio transfer opportunities. We will report back to your Board, should conditions change, and action on our part is indicated.

Should you or staff have any questions regarding this matter, please contact Rocky Armfield, Risk Manager, at (213) 351-5346, or at rarmfield@cao.co.la.ca.us.

DEJ:SRH
RAA:AJR:mtm

c: Executive Officer, Board of Supervisors
County Counsel
Auditor-Controller
Director of Personnel
Treasurer and Tax Collector